(1)

Supreme Court, U.S.
FILED

011078 JAN - 2 2002

OFFICE OF THE CLERK

No. 01-___

IN THE

Supreme Court Of The United States

Beverly Burden, Chapter 13 Trustee for the Estates of Luther Gilbert, Jr., Victoria Tevis, Santina Turner, and Frank Lewis Bradshaw; and Francine Jackman, Elaine Steward Greene, Luther Gilbert, Jr., Victoria Tevis, Santina Turner, and Frank Lewis Bradshaw, Individually

Petitioners,

v.

Check Into Cash of Kentucky, LLC, W. Allan Jones, Jr. and Unknown Entities and Individuals

Respondents,

v.

Commonwealth of Kentucky, Department of Financial Institutions,

Third-Party Respondent

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

Jack L. Block
(Counsel of Record)
Sachnoff & Weaver Ltd.
30 S. Wacker Drive, 29th Fl.
Chicago, IL 60606-7484
312/207-1000

Richard Fisher
Logan, Thompson, Miller,
Bilbo, Thompson & Fisher her
30 Second Street
Cleveland, TN 37364-0191
423/479-7009

6191

John O. Morgan, Jr.
First National Building
167 West Main Street,
Suite 100
Lexington, KY 40507
859/253-6500

F. Paul Bland, Jr.
Michael J. Quirk
Trial Lawyers for Public
Justice, P.C.
1717 Massachusetts Avenue,
N.W., Suite 800
Washington, D.C. 20036
202/797-8600

QUESTION PRESENTED

Whether, under the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.*, a court must enforce an arbitration clause when the consumer loan contract in which it appears is alleged to be void *ab initio* as illegal and against public policy under applicable state law. The Sixth Circuit below acknowledged that the Federal Circuit Courts are split over whether this Court's holding in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), should be extended to require arbitration of allegations that the underlying contract is void *ab initio* and therefore never existed.

PARTIES TO THE PROCEEDING

The parties to the proceedings below were petitioners Beverly Burden, Chapter 13 Trustee for the Estates of Luther Gilbert, Jr., Victoria Tevis, Santina Turner, and Frank Lewis Bradshaw; and Francine Jackman, Elaine Steward Greene, Luther Gilbert, Jr., Victoria Tevis, Santina Turner, and Frank Lewis Bradshaw, Individually (as appellees) and respondents Check Into Cash of Kentucky, LLC, W. Allan Jones, Jr. (as appellants) and John Doe(s), Unknown Entities and Individuals (as defendants).

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

PARTIES TO THE PROCEEDING ii

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

JURISDICTION 1

STATUTORY PROVISIONS INVOLVED 1

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE WRIT 9

I. There is a Split Among the Circuits Over Whether the FAA Requires Enforcement of an Arbitration Provision in a Contract that is Alleged to be Void *Ab Initio*. 11

II. The Ruling Below Directly Conflicts with State Court Decisions Applying the FAA and Requiring Judicial Resolution of Identical Allegations that a Usurious Contract is Void *Ab Initio*. 15

III. The Decision Below Also Conflicts with this Court's Holdings that the FAA Places Arbitration Clauses on the Same Footing as Other Contract Provisions. 18

CONCLUSION 20

TABLE OF AUTHORITIES

Cases

Alabama Catalog Sales v. Harris, 794 So.2d 312 (Ala. 2000). 10, 16

Allied-Bruce Terminix Co's, Inc. v. Dobson, 513 U.S. 265 (1995) 19

C.B.S. Employees Federal Credit Union v. Donaldson, Lufkin and Jenrette Securities, 912 F.2d 1563 (6th Cir. 1990). 14

Chastain v. Robinson-Humphrey Co., Inc., 957 F.2d 851 (11th Cir. 1992). 13

Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996) 18-19

Fastfunding Company, Inc. v. Betts, 758 So.2d 1143 (Fla. App. 2000). 10, 17

I.S. Joseph Co., Inc. v. Michigan Sugar Co., 803 F.2d 396 (8th Cir. 1986). 13

Party Yards, Inc. v. Templeton, 751 So.2d 121 (Fla. App. 2000). 16-17

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) . . . . . *passim*

Lawrence v. Comprehensive Bus. Servs. Co., 933 F.2d 1159 (5th Cir. 1987). 9, 13-14

Sandvik AB v. Advent Int'l Corp., 220 F.3d 99 (3d Cir. 2000). 9, 12,

Southland Corp. v. Keating, 465 U.S. 1 (1984) 17

Sphere Drake Ins. Ltd. v. All American Ins. Co., 256 F.3d 587 (7th Cir. 2001). 13

Three Valleys Munic. Water Dist. v. E.F. Hutton & Co., 925 F.2d 1136 (9th Cir. 1991). 9, 12, 14, 15

Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1989). 18

Statutes and Legislative Materials

Federal

Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.* ..... *passim*

9 U.S.C. § 2. 2

9 U.S.C. § 3. 2-3

28 U.S.C. § 1254(1). 2-3

Fed. R. Civ. P. 23(c)(1) ..... ##

H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924) 18

Racketeer Influenced and Corrupt Practices Act, 18 U.S.C. §§ 1961 *et seq.* 6

Truth In Lending Act, 15 U.S.C. §§ 1601 *et seq.* 6

State

KY. REV. STAT. §§ 288.410 *et seq.* 6

KY. REV. STAT. § 288.620(2). 2, 8

KY. REV. STAT. § 288.991(1). 2, 7-8

KY. REV. STAT. §§ 360.010 *et seq.* 6

KY. REV. STAT. § 360.210 *et seq.* 6

KY. REV. STAT. §§ 367.110 *et seq.*. 6

KY. REV. STAT. § 506.120(3)(f). 8

Miscellaneous

Black's Law Dictionary, 6th ed. (West Publ. Co. 1991). 11

OPINIONS BELOW

The opinion of the U.S. Court of Appeals for the 6th Circuit (App. 1-18) is reported at 267 F.3d 483 (2001). The unreported opinion of the U.S. District Court for the Eastern District of Kentucky (App. 19-22) was entered on May 12, 2000. The opinion of the Kentucky Supreme Court in *White v. Check Holders, Inc.* (App. 23-31) on the certified question for which this case was held in abeyance is reported at 996 S.W.2d 496 (1999).

JURISDICTION

The judgment of the court of appeals was entered on October 1, 2001. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The substantive provision of the Federal Arbitration Act of 1925 ("FAA") at issue, 9 U.S.C. § 2, reads as follows:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract.

The procedural provision of the FAA at issue, 9 U.S.C. § 3, reads as follows:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

The state law provisions that are the basis for Petitioners' allegations at issue in this petition read as follows:

KY. REV. STAT. § 288.991:

> (1) Any person who shall engage in the business regulated by this chapter without first securing a license therefor shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not less than five hundred dollars ($500) nor more than five thousand dollars ($5,000). Any loan contract made in violation of this chapter shall be void and the lender shall have no right to collect any principal, charges, or recompense whatsoever.

KY. REV. STAT. § 288.620:

> (2) Any loan in the amount of fifteen thousand dollars ($15,000) or less for which there has been charged, contracted for or received a greater rate of interest, discount or consideration, except as provided for by statute, is against the public policy of this state.

STATEMENT OF THE CASE

This case presents the question of whether, under the FAA, a court must enforce an arbitration provision when the consumer loan contract in which it appears is alleged to be void *ab initio* as illegal and against public policy under applicable state law. A deep split of appellate authority has emerged on this issue as at least two federal circuit courts, including the court below, have referred such allegations to arbitration, while five circuits and one state's highest cour have held that a court must first decide the existence of a legal contract before it can enforce an arbitration clause under the FAA.

The Sixth Circuit below acknowledged a split over whether this Court's holding in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), that allegations of fraudulent inducement in the making of a contract containing an arbitration clause are subject to arbitration, should be extended to require arbitration of allegations that the underlying contract is void *ab initio* and therefore never existed. App. 7-8. Petitioners alleged below that Respondents' entire payday loan contract (including its arbitration provision) was void because Respondents are unlicensed lenders and are charging usurious interest rates. By holding that these claims must be arbitrated, the Sixth Circuit deepened this split of federal authority and came into direct conflict with various state court decisions holding that courts must decide under the FAA whether a loan contract is void *ab initio* before ordering enforcement of the contract's mandatory arbitration provision.

A. The Parties' Payday Loan Transactions.

Respondents Check Into Cash of Kentucky and W. Allan Jones, Jr. began making what are commonly referred to as

"payday loans" (or "deferred deposit transactions") in Kentucky in the summer of 1995.[1] Payday loans are a form of consumer loan characterized by short-term borrowing periods coupled with exorbitant interest rates. Advertising itself as a licensed check-cashing service, Respondent advanced money to needy customers by charging them $19 per $100 borrowed for a two-week period. Thus, a typical borrower might write out a check to Respondent for $238 in exchange for $200 in cash with payment of the amount stated on the check due two weeks later. If a borrower were unable to pay her check in full when it came due, Respondent would have the borrower "roll over" the debt by paying an additional $38 fee for a two-week extension of the $200 loan. Stated as an annual percentage rate, the interest on Respondent's loans was typically around 500% and sometimes exceeded 900%.[2]

In December 1997, shortly after a plaintiff class of borrowers was certified against Respondents in a neighboring state, Respondents added a mandatory arbitration provision to their Kentucky consumer contracts. This arbitration clause provides as follows:

---

[1] As will be discussed below, one of the central disputes in this case that has already been resolved was the question of whether these transactions involved loans, as Petitioners alleged, or check cashing fees, as Respondents alleged. The Kentucky Supreme Court decided this issue unanimously in favor of Petitioners' contention that these are consumer loan transactions.

[2] Petitioners alleged in their complaint that one of them had been required to pay Respondents approximately $1,500 in interest for the use of $200 during a two-year period. Plaintiffs' Second Amended Complaint ¶57.

ARBITRATION: To pursue any claim, demand, dispute or cause of action (a "claim") arising under this Agreement or the transaction in connection with which this Agreement has been executed, the claimant must submit to the other party in writing an explanation of the claim and a demand that the claim be resolved by arbitration. If the other party does not respond to the submittal in writing within ten (10) days of its receipt, the claimant may pursue the claim either through arbitration or court action. If the other party responds to the submittal in writing within ten (10) days of its receipt, the claim must be submitted to binding arbitration in accordance with and pursuant to the Uniform Arbitration Act as enacted in the Commonwealth of Kentucky, KRS 417.045 et seq., as amended from time to time (the "Act"). The arbitration shall be conducted by one or more arbitrators selected by agreement between you and Check Into Cash but, if no agreement on the arbitrator[s] can be reached, by the Kentucky District Court for claims involving $4000 or less or the Kentucky Circuit Court, in either case, in the county where this Agreement was signed. The expenses of the arbitration, including attorney's fees, will be paid in accordance with the award issued by the arbitrator[s]. The finality and binding effect of the arbitration award shall be as set forth in the Act.

App. 5. The question before the Court is whether this provision can be enforced in light of Petitioners' allegations concerning the voidness and intrinsic illegality of the payday loan contract in which it appears.

B. The Proceedings Below.

Petitioners, a putative class of borrowers, filed suit against Respondents on April 28, 1998, in the federal district court for the Eastern District of Kentucky, charging that the services Respondents provided were consumer loans. The complaint alleged that Respondents' payday loan contracts violated the federal Truth in Lending Act (15 U.S.C. §§ 1601 *et seq.*), the Racketeer Influenced and Corrupt Practices Act (18 U.S.C. §§ 1961 *et seq.*) and Kentucky's Consumer Loans Act (KY. REV. STAT. §§ 288.410 *et seq.*), Interest and Usury Statute (KY. REV. STAT. §§ 360.010 *et seq.*), Disclosure of Finance Charges on Installment Credit Transactions Act (KY. REV. STAT. §§ 360.210 *et seq.*), and Consumer Protection Act (KY. REV. STAT. §§ 367.110 *et seq.*). Petitioners also asserted a common law fraud claim against Respondents.

Petitioners' complaint alleged that Respondents charged and collected usurious interest for short-term consumer loans under the guise of cashing checks. Petitioners alleged that the charges on these loans resulted in annual percentage rates of more than 50 times Kentucky's 8% usury threshold. Petitioners further alleged that Respondents induced them to roll these loans over for additional charges by threatening to prosecute them under Kentucky's bad check law, even though they had not obtained their loans with legally enforceable checks.

On June 2, 1998, rather than seeking arbitration, Respondents elected to avail themselves of the judicial system by moving to certify a dispositive legal question to the Kentucky Supreme Court. The Kentucky Supreme Court accepted certification of an almost identical question in a related case. The question reads as follows:

> When a check cashing company licensed under KRS 368 *et seq.* accepts and defers deposit on a check

pursuant to an agreement with the maker of the check, is the service fee charged by the check cashing company a "service fee" and not "interest" under KRS 368.100(2), or is the fee "interest" which is subject to the usury laws and disclosure provisions in KRS Chapter 360?

App. 24. Recognizing that the answer to this question would effectively resolve the issue of whether Respondents' payday loan contracts are illegal under Kentucky usury law, the district court on August 25, 1998 ordered that this case be held in abeyance pending the Kentucky Supreme Court's resolution of this question in an analogous case.

On June 17, 1999, the Kentucky Supreme Court unanimously held that deferred deposit transactions like Respondents' payday loans are not exempted by Kentucky's statute licensing check-cashing businesses, KY. REV. STAT. § 368.100(2), from application of other State laws, including usury laws and disclosure provisions that are the basis for many of Petitioners' claims in this case.

With the certified question of Kentucky law answered conclusively in Petitioners' favor by the State's highest court, litigation in this case resumed in the federal district court. On December 1, 1999, Petitioners moved to proceed as a class action under Fed. R. Civ. P. 23(c)(1). On January 6, 2000, Respondents filed a motion under the FAA to compel arbitration of Petitioners' claims.

Petitioners argued in response to the motion to compel that the arbitration clause in Respondents' consumer loan contract is unenforceable because the entire contract is void *ab initio* and against well-defined public policy under applicable Kentucky

statutes governing the licensing of consumer loan agreements and usury. *See, e.g.*, KY. REV. STAT. § 288.991(1) (loan contract made by unlicensed lender "shall be void and the lender shall have no right to collect any principal, charges, or recompense whatsoever"); KY. REV. STAT. § 288.620(1) (loans of $15,000 or less with interest in excess of statutory cap are "against the public policy of this state"); KY. REV. STAT. § 506.120(3)(f) (defining as "criminal syndicate" operation by five or more persons to engage in "[l]ending at usurious interest, and enforcing payment by illegal means").[3] Respondents countered that this argument itself must be referred to arbitration, citing the FAA and this Court's decision in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

On May 12, 2000, the district court issued an order denying Respondents' motion to compel arbitration of Petitioners' claims on the ground that Petitioners had raised an argument challenging the existence of the agreement containing the arbitration clause. App. 22. While finding that Petitioners' argument that the entire payday loan contract was void *ab initio* was not referable to arbitration because it implicated the very existence of an agreement to arbitrate, the district court did not make any finding as to whether the contract was in fact void. Respondents appealed this order.

---

[3] Petitioners also argued that Respondents had waived any right to compel arbitration by engaging in extensive litigation activity, that the arbitration clause is unconscionable, and that the particular terms of the arbitration clause would prevent them from vindicating their rights under the various statutes at issue in this case. These arguments are not at issue in this petition.

On October 1, 2001, the Sixth Circuit vacated the district court's order, holding that Petitioners' allegations that Respondents' payday loan contract is void *ab initio* based on its usurious terms and on Respondents' lack of signatory authority must be resolved through arbitration. The Sixth Circuit recognized a split of federal appellate authority over whether *Prima Paint* should be extended to require arbitration of allegations of nonexistent contracts, noting that the Third Circuit in *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 107 (2000), and the Ninth Circuit in *Three Valleys Municipal Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1140 (1991), had expressly found that "*Prima Paint* applies to voidable, but not void, contracts," whereas the Fifth Circuit in *Lawrence v. Comprehensive Bus. Servs. Co.*, 933 F.2d 1159, 1162 (5th Cir. 1987), found that *Prima Paint* applies to contracts alleged to be void from their inception. App. 7-8. While the Sixth Circuit itself found that "[t]he void/voidable distinction is relevant for *Prima Paint* analysis because a void contract, unlike a voidable contract, was never a contract at all," the court nonetheless held that Petitioners' allegation that the entire payday loan contact is void *ab initio* as a matter of Kentucky law must be resolved through arbitration pursuant to the mandatory arbitration provision in the contract whose very existence was at issue. App. 7, 11. The court remanded the case to the district court for consideration of Petitioners' other challenges to the arbitration clause itself. This petition followed.

REASONS FOR GRANTING THE WRIT

The petition for certiorari should be granted because the federal and state appellate courts that are frequently called upon to apply the FAA are divided on this important question of federal law. The Sixth Circuit acknowledged that the Third and Ninth Circuits had held that allegations that a contract

containing an arbitration clause is void *ab initio* must be resolved by a court before the arbitration clause can be enforced under the FAA, but nonetheless held that Petitioners' allegation that Respondents' payday loan contract is void under Kentucky law must be resolved through arbitration. Not only does the Sixth Circuit's decision plainly conflict with the cases cited by the court itself, but it also creates an irreconcilable conflict with decisions from state courts applying the FAA to nearly identical facts to hold that a court must decide allegations that a loan contract containing an arbitration clause is void *ab initio* under state usury and consumer lending laws. *See, e.g., Alabama Catalog Sales v. Harris*, 794 So.2d 312 (Ala. 2000); *Fastfunding Company, Inc. v. Betts*, 758 So.2d 1143 (Fla. App. 2000).

The petition should also be granted because the decision below is in tension with this Court's numerous precedents holding that the FAA subjects arbitration agreements to the same generally applicable rules of contract law that apply to other contractual provisions. By extending *Prima Paint* to require enforcement of an arbitration clause where the legality (and indeed the very existence) of the contract in which that clause appears are called into question, the Sixth Circuit has singled out arbitration clauses for special treatment by allowing them to be enforced when the very existence of a legal contract is in dispute. The ruling below is difficult to square with this Court's repeated holdings that the FAA does no more than place arbitration clauses on the "same footing" as other contracts. The petition for certiorari should be granted so the Court can resolve these conflicts.

I. There is a Split Among the Circuits Over Whether the FAA Requires Enforcement of an Arbitration Provision in a Contract that is Alleged to be Void *Ab Initio*.

This Court held in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), the Federal Arbitration Act requires that a party's allegation that a contract containing an arbitration clause was fraudulently induced must be resolved by an arbitrator rather than by a court. *Id.* at 404. As was recognized by the court below, the fraudulent inducement claim in *Prima Paint* would have rendered the underlying contract *voidable* by the parties, but it would not have rendered the contract void from its inception. *See* App. 8. The conflict among the circuits that the lower court described is over whether *Prima Paint* should be extended to require a party to arbitrate the allegation that the underlying contract is void *ab initio*, meaning that "it has at no time had any legal validity," Black's Law Dictionary 3 (6th ed. 1991), and therefore never existed as a basis for requiring arbitration.

The conflict among the federal circuit courts over whether the FAA requires enforcement of an arbitration clause in the face of allegations that the entire contract containing the clause is void *ab initio* is well recognized and is plainly implicated by the facts and allegations at issue in this case. The lower court discussed the circuit split on this issue, noting that "[s]everal of our sister circuit courts have found that *Prima Paint* does not apply to allegations of nonexistent contracts," that the "Third Circuit and the Ninth Circuit, respectively, have found that *Prima Paint* applies to voidable, but not void, contracts," and that "[i]n contrast, the Fifth Circuit has found that *Prima Paint* applies even to contracts that are 'void from...inception.'" App. 7-8. The Sixth Circuit's decision requiring arbitration of

Petitioners' allegations that the payday loan contract is void *ab initio* only deepens this conflict.

As the court below recognized, numerous federal circuit courts have declined to extend this Court's holding in *Prima Paint* regarding allegations of fraud in the inducement of a contract containing an arbitration clause to the different allegation that such a contract is void *ab initio* and therefore never existed in the first place. In *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99 (3d Cir. 2000), for example, the Third Circuit, in an opinion by Chief Judge Becker, held that a party cannot enforce an arbitration clause while denying that it is bound by the contract containing that clause because, "[e]ven under the severability doctrine [of *Prima Paint*], there may be no arbitration if the agreement to arbitrate is non-existent." *Id.* at 101. The Third Circuit went on to limit *Prima Paint* to apply only to allegations that a contract is *voidable* while requiring courts to resolve allegations that a contract with an arbitration clause is *void* or non-existent:

> Mindful of the doctrine announced in *Prima Paint*, which did not consider a situation in which the *existence* of the underlying contract was at issue, we draw a distinction between contracts that are asserted to be "void" or non-existent, as is contended here, and those that are merely "voidable," as was the contract at issue in *Prima Paint*, for purposes of evaluating whether the making of an arbitration agreement is in dispute.

Id. at 107. The lower court's holding, which applies the FAA to require arbitration of Petitioners' allegation that Respondents' payday loan contract is void *ab initio*, thus plainly conflicts with the Third Circuit's *Sandvik* decision.

Several other circuits have, like the Third Circuit in *Sandvik* but contrary to the court below, declined to extend *Prima Paint* to apply to allegations that a contract containing an arbitration clause is void *ab initio*. *Sandvik* was based largely on the earlier decision in *Three Valleys Municipal Water Dist. v. E.F. Hutton & Co., Inc.*, 925 F.2d 1136 (9th Cir. 1991), where the Ninth Circuit held that a court rather than an arbitrator must resolve the threshold dispute over the existence of a contract containing an arbitration clause where one party disputes the authority of a signatory to the contract. *Three Valleys* limited *Prima Paint* to require arbitration only of "challenges seeking to *avoid* or *rescind* a contract," and held that courts must decide "challenges going to the very existence of a contract that a party claims never to have agreed to." *Id.* at 1140 (emphasis in original). Similarly, the Seventh Circuit recently held that a court must decide whether there was an enforceable contract containing an arbitration provision where one of the parties disputed the authority of its agent to make the contract. *See Sphere Drake Ins. Ltd. v. All American Ins. Co.*, 256 F.3d 587 (7th Cir. 2001). The Seventh Circuit found that "as arbitration depends on a valid contract an argument that the contract does not exist can't logically be resolved by the arbitrator" or, stated more simply, "[n]o contract, no power." *Id.* at 591; *see also Chastain v. Robinson-Humphrey Co., Inc.*, 957 F.2d 851 (11th Cir. 1992) (court must resolve allegation that party's signature to contract containing arbitration clause was forged); *I.S. Joseph Co., Inc. v. Michigan Sugar Co.*, 803 F.2d 396 (8th Cir. 1986) (court must decide whether assignee can enforce contract with arbitration clause).

Even prior to the decision below, the Fifth and Sixth Circuits adopted a contrary position by holding that *Prima Paint* should be extended to require arbitration of allegations that an underlying contract is void *ab initio*. In *Lawrence v.*

Comprehensive Business Services Co., 833 F.2d 1159 (5th Cir. 1987), the Fifth Circuit applied *Prima Paint* to require arbitration of a party's allegation that a franchise contract containing an arbitration clause was void under applicable Texas law. The Fifth Circuit concluded:

> This court has applied *Prima Paint* to hold an arbitration clause enforceable in spite of a claim that the gas sales contract containing it was void from its inception because of the parties' failure to comply with a state statute regulating the sale of the state's gas. We regard this case as indistinguishable.

Id. at 1162. The Sixth Circuit likewise had previously held that an allegation of fraud in the factum of a contract containing an arbitration clause must be referred to arbitration. *See C.B.S. Employees Federal Credit Union v. Donaldson, Lufkin and Jenrette Securities*, 912 F.2d 1563 (6th Cir. 1990). As the court below recognized, the fraud in the factum claim in *C.B.S. Employees* would have rendered the contract void or non-existent, rather than merely voidable as with the fraud in the inducement claim in *Prima Paint*. *See* App. 8. There have thus emerged at least two conflicting positions among the federal circuit courts over whether this Court's *Prima Paint* decision should be extended to require arbitration of allegations that a contract containing an arbitration clause is void *ab initio*.

The decision below deepens the circuit split on the question presented by partially embracing the void/voidable distinction for purposes of applying *Prima Paint*. First, the court drew a further distinction among different types of voidness allegations by holding that some of Petitioners' claims must go to arbitration because they challenge the substance, rather than the existence, of the payday loan contract even though they would

render the contract void *ab initio*. App. 11. The court then acknowledged that Petitioners were also in part challenging Respondents' signatory power by arguing that they were not licensed to make these loans under Kentucky law, but still found that the Ninth Circuit's *Three Valleys* decision did not apply and that this claim must be arbitrated. App. 12. The only distinction that the court could draw between this case and *Three Valleys* was that the latter involved allegations that the party opposing arbitration lacked signatory power while the instant case involves a challenge to the moving party's signatory power. App. 12. This distinction cannot be squared with the rationale of the Ninth Circuit's ruling in *Three Valleys* and is flatly contrary to the principle enunciated by Chief Judge Becker in *Sandvik* regarding void and voidable contracts.

The Sixth Circuit's opinion in this case deepens the circuit split over whether *Prima Paint* should be extended to require arbitration of allegations that an underlying contract is void *ab initio*. The Third Circuit has squarely held that *Prima Paint* does not apply to allegations that a contract is void. The Seventh, Eighth, Ninth, and Eleventh Circuits have similarly refused to extend *Prima Paint* to challenges to the existence of the underlying contract. The Fifth and Sixth Circuits, by contrast, have held that *Prima Paint* requires arbitration of voidness allegations. The decision below extends *Prima Paint* to require arbitration of some, but not all, allegations that an underlying contract is void *ab initio* and therefore never existed in the first place. This Court should grant review to resolve this split of authority on the important and recurring question of whether the FAA forces parties to relinquish their access to court in favor of arbitration when they allege illegality and dispute the very existence of the contract that would require them to arbitrate.

II. The Ruling Below Directly Conflicts with State Court Decisions Applying the FAA and Requiring Judicial Resolution of Identical Allegations that a Consumer Loan Contract is Void *Ab Initio*.

While the Sixth Circuit below acknowledged the conflicting opinions among the federal circuit courts over whether *Prima Paint* should be extended to reach allegations that an underlying contract is void *ab initio*, the court failed to address any of the state court decisions ordering judicial resolution of allegations identical to those raised by Petitioners. For example, in another case involving payday lending practices, the Alabama Supreme Court recently held that a party's allegation that a loan contract is void under a state statute because of its usurious interest rates must be resolved by a court before the contract's arbitration provision can be enforced under the FAA. *Alabama Catalog Sales v. Harris*, 794 So.2d 312, 317 (Ala. 2000). In rejecting the lender's argument that the borrowers' allegation of illegality should be sent to arbitration under *Prima Paint*, *Harris* explained that "[b]ecause the present case turns on the question whether a contract exists and *Prima Paint* is inapplicable to challenges going to the very existence of a contract, *Prima Paint* is inapplicable in this case and the defendant's reliance upon that case is misplaced." *Id.* at 315. The Alabama Supreme Court's holding in *Harris* squarely conflicts with the Sixth Circuit's decision in this case. Both cases address the allegation that a payday loan contract containing a mandatory arbitration provision is void under state usury laws. The divergent holdings of the two courts over who resolves these allegations under the FAA and *Prima Paint* points up a further need for this Court's review on the question presented.

There are several other state court decisions applying the FAA and requiring judicial resolution of allegations that the

underlying contract is void because of illegal provisions. In *Party Yards, Inc. v. Templeton*, 751 So.2d 121 (Fla. Dist. Ct. App. 2000), the court held that allegations that a loan contract between businesses is void *ab initio* based on state usury laws must be resolved by a court before the contract's arbitration clause can be enforced under the FAA. The court explained that "[a]s a matter of law, a usury violation does not arise under an agreement," that "usury arises under state statutory law," and that "*no court will lend its assistance in any way towards carrying out the terms of an illegal contract.*" *Id.* at 123 (emphasis added). The court concluded that *Prima Paint* is inapplicable to this challenge to the existence of a legal contract. *Id.*; *see also Fastfunding Co., Inc. v. Betts*, 758 So.2d 1143 (Fla. Dist. Ct. App. 2000) (holding in payday loan case that court must resolve borrower's allegation that entire loan contract with arbitration clause is void *ab initio* under state usury laws before clause can be enforced under FAA). These rulings, like that of the Alabama Supreme Court in *Harris*, are in irreconcilable conflict with the decision below in their interpretations of the FAA.

This conflict between the Sixth Circuit's ruling below and these state court opinions providing a contrary interpretation of the FAA should be resolved by this Court because this important question of federal law will continue to arise in both federal and state courts. This Court has long recognized that, "[w]hile the Federal Arbitration Act creates federal substantive law requiring the parties to honor arbitration agreements, it does not create any independent federal-question jurisdiction under 28 U.S.C. § 1331 or otherwise." *Southland Corp. v. Keating*, 465 U.S. 1, 15 n.9 (1984). Since both federal and state courts are routinely required to apply the FAA in cases like this one, the conflict between these state court decisions and the ruling of the court below presents an additional basis for this Court to

take up the question of whether the FAA requires enforcement of an arbitration provision in a contract that is alleged to be void *ab initio*.

III. The Decision Below Also Conflicts with this Court's Holdings that the FAA Places Arbitration Clauses on the Same Footing as Other Contract Provisions.

The lower court's ruling applies the FAA in a way that belies this Court's repeated interpretations of the Act. This Court has on many occasions held that the federal policy regarding arbitration is simply one of enforcing contracts and that the FAA does no more or less than place arbitration agreements on the same footing as other contracts. In *Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Jr. Univ.*, 489 U.S. 468 (1989), the Court held that a state statute allowing for a stay of arbitration pending the resolution of related judicial proceedings was not preempted by the FAA, despite the absence of such a provision in the federal act, where the parties to an arbitration agreement had elected in their contract to have state law govern. The Court explained that the FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms," and that the Act places such agreements "'upon the same footing as other contracts.'" *Id.* at 478 (H.R. Rep. No. 96, 68th Cong., 1st Sess., 1, 2 (1924)) (citation omitted).

The command of the FAA to apply the same rules of contract law to arbitration agreements as apply to all other contractual terms has been central to this Court's explanations of the Act's preemptive effect on state laws. In *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), the Court held that the FAA preempted a state statute imposing specific disclosure requirements for arbitration agreements. The Court

echoed its earlier decisions in explaining that, through the FAA, "Congress precluded states from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed upon the same footing as other contracts." *Id.* at 687 (internal quotation omitted). In an earlier decision on FAA preemption, the Court elaborated on the fact that the FAA does no more than place arbitration clauses on the same footing as other contracts and contractual provisions:

> States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.' 9 U.S.C. § 2 (emphasis added). What states may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress' intent.

Allied-Bruce Terminix Co's, Inc. v. Dobson, 513 U.S. 265, 281 (1995). By extending *Prima Paint* to require enforcement of an arbitration clause when the entire contract in which it appears is alleged to be illegal and void *ab initio*, the decision below is in tension with this Court's repeated interpretations of the FAA.

Petitioners' allegations attacking the legality of Respondents' payday loan contract present the inverse of what this Court hypothesized in *Allied-Bruce Terminix*. Petitioners allege that Respondents had no authority to make this contract under Kentucky law because they were not licensed to make consumer loans. Petitioners further allege that Respondents'

excessive interest rates render the entire loan contract void *ab initio* under Kentucky's usury laws. Respondents argued in response, and the Sixth Circuit held, that the arbitration provision of this allegedly illegal and void contract must be singled out from its other terms and given effect before there is a determination as to whether all of the contract (including the arbitration clause) is legal. This is not an application of ordinary contract law and this does not place the arbitration clause on the same footing as the other provisions in Respondents' payday loan agreement. Instead, the ruling below misapplies the FAA to require arbitration where the basic question of whether there was ever a legal contract, and therefore whether there was ever an arbitration agreement, between the parties is still in dispute.

Because the decision below is in tension with this Court's repeated interpretations of the FAA and because this decision deepens an already substantial split of authority among federal and state appellate courts on the question of whether the FAA requires enforcement of an arbitration provision in an allegedly void and illegal contract, this Court should grant review and resolve these conflicts on this important question of federal law.

CONCLUSION

This petition for a writ of *certiorari* should be granted.

Respectfully submitted,

John O. Morgan, Jr.
(Counsel of Record)
First National Building
167 West Main Street, Suite 100
Lexington, KY 40507
859/253-6500

Richard Fisher
Logan, Thompson, Miller, Bilbo, Thompson & Fisher
30 Second Street
Cleveland, TN 37364-0191
423/479-7009

Jack Block
Sachnoff & Weaver Ltd.
30 S. Wacker Drive, 29th Floor
Chicago, IL 60606-7484
312/207-1000

F. Paul Bland, Jr.
Michael J. Quirk
Trial Lawyers for Public Justice, P.C.
1717 Massachusetts Avenue, NW, Suite 800
Washington, D.C. 20036
202/797-8600

Counsel for Petitioners

Date: January 2, 2001

RECOMMENDED FOR FULL-TEXT PUBLICATION

Pursuant to Sixth Circuit Rule 206

ELECTRONIC CITATION: 2001 FED App. 0349P
(6th Cir.)

File Name: 01a0349p.06

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

Beverly Burden, et al., *Plaintiffs-Appellees,* *v.* Check into Cash of Kentucky, LLC, et al., *Defendants-Appellants,*	*No. 00-5807*

Appeal from the United States District Court
for the Eastern District of Kentucky at Lexington.
No. 98-00170--Karl S. Forester, Chief District Judge

Argued: August 2, 2001

Decided and Filed: October l, 2001

Before: CLAY and GILMAN, Circuit Judges; WISEMAN, District Judge.(*)

COUNSEL

ARGUED: Barbara B. Edelman, DINSMORE & SHOHL, Lexington, Kentucky, for Appellants. John O. Morgan, Jr., Lexington, Kentucky, for Appellees. **ON BRIEF**: Barbara B. Edelman, Frank T. Becker, DINSMORE & SHOHL, Lexington, Kentucky, for Appellants. John O. Morgan, Jr., Lexington, Kentucky, Richard A. Fisher, LOGAN, THOMPSON, MILLER, BILBO, THOMPSON & FISHER, Cleveland, Tennessee, Jack L. Block, SACHNOFF & WEAVER, Chicago, Illinois, for Appellees.

OPINION

CLAY, Circuit Judge. Defendants, Check Into Cash of Kentucky, LLC, and W. Allan Jones, Jr., appeal from the district court's order denying Defendants' motion brought pursuant to the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq.*, to compel arbitration of claims brought by Plaintiffs, Beverly Burden, Chapter 13 bankruptcy trustee for multiple estates, *et al.*, alleging violations of federal and Kentucky law arising from high-interest loan agreements between Plaintiffs and Defendants. We **VACATE** the district court's order and **REMAND** for further consideration of Defendants' motion to compel arbitration in light of Plaintiffs' allegations that the arbitration agreements are unenforceable due to burdensome costs, denial of statutory rights, and uninformed waiver of jury trial rights.

BACKGROUND

Procedural History

Plaintiffs filed their original complaint in the district court on April 28, 1998, which was amended on May 5, 1998. On July 6, 1998, Plaintiffs filed their second amended complaint, alleging violations of the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 *et seq.*, the Racketeer Influenced and Corrupt Organization Act, 18 U.S.C. § 1961 *et seq.*, and several consumer protection statutes under Kentucky law. On June 2, 1998, Defendants moved to certify a question of law to the Kentucky Supreme Court: whether fees charged by a licensed check cashing company constituted interest subject to Kentucky usury laws. On August 25, 1998, the district court ordered Plaintiffs' action to be held in abeyance pending resolution of the question by the Kentucky Supreme Court.

On June 17, 1999, the Kentucky Supreme Court answered the certified question, finding that a check cashing company licensed under Kentucky Revised Statutes § 368 *et seq.*, which charges a "service fee" for accepting and deferring deposit on checks pursuant to agreements with the makers of the checks, thereby charges "interest" subject to the usury laws and disclosure provisions under § 360. *See White v. Check Holders, Inc.*, 996 S.W.2d 496, 500 (Ky. 1999).

On December 1, 1999, Plaintiffs moved to proceed as a class action pursuant to Fed R. Civ. P. 23(c)(1). Defendants thereafter moved for an extension of time to respond to Plaintiffs' motion. On January 6, 2000, Defendants filed a motion under the FAA to compel arbitration of claims brought by Plaintiffs, and to stay litigation pending arbitration. The district court denied Defendants' motion on May 12, 2000, and

it is from this order that Defendants now appeal.

Facts

Plaintiff Burden is trustee for four bankruptcy estates in this case. The individual Plaintiffs are residents of Lexington, Kentucky. Defendant Check Into Cash, creditor of the bankruptcy estates and individual Plaintiffs in this case, is incorporated and does business in Kentucky. Defendant W. Allan Jones, Jr., is a majority owner and managing officer of Check Into Cash.

Plaintiffs allege that Defendants have loaned money at usurious interest rates to hundreds of Kentucky consumers. The consumers entered into "check cashing agreements" with Defendants (the "loan agreements"). Under the loan agreements, Defendants would provide a borrower with, for example, $200 in cash in exchange for a check in the amount of $238. The loan agreement would refer to the $38 difference as a "finance charge," which, the agreement stated, "is deemed a service fee by Kentucky law and not interest. K.R.S. 368.100(2)." (J.A. at 458.)

Defendants would then hold the check until the payment due date, which was normally two weeks after the date of the loan agreement. These terms resulted in annual percentage rates of over 500%, which was stated in the loan agreement. If, as of the payment due date, the borrower lacked sufficient funds to cover the check, Defendants would permit the borrower to roll-over the debt by paying the "service fee," executing a replacement check in the same amount as the original check, and establishing a new payment due date two weeks from the roll-over date. Plaintiffs allege that Defendants coerced borrowers into rolling over their debt by threatening otherwise to prosecute under the Kentucky "bad check" *law. See* Ky. Rev.

Stat. Ann. § 514.040 (Banks-Baldwin 1994).

The loan agreements at issue contained an arbitration clause, on the reverse side of the loan agreement, which read as follows:

> ARBITRATION: To pursue any claim, demand, dispute or cause of action (a "claim") arising under this Agreement or the transaction in connection with which this Agreement has been executed, the claimant must submit to the other party in writing an explanation of the claim and a demand that the claim be resolved by arbitration. If the other party does not respond to the submittal in writing within ten (10) days of its receipt, the claimant may pursue the claim either through arbitration or court action. If the other party responds to the submittal in writing within ten (10) days of its receipt, the claim must be submitted to binding arbitration in accordance with and pursuant to the Uniform Arbitration Act as enacted in the Commonwealth of Kentucky, KRS 417.045, et seq., as amended from time to time (the "Act"). The arbitration shall be conducted by one or more arbitrators selected by agreement between you and Check Into Cash but, if no agreement on the arbitrator[s] can be reached, by the Kentucky District Court for claims involving $4000 or less or the Kentucky Circuit Court, in either case, in the county where this Agreement was signed. The expenses of the arbitration, including attorney's fees, will be paid in accordance with the award issued by the arbitrator[s]. The finality and binding effect of the arbitration award shall be as set forth in the Act.

(J.A. at 451, 558.)

Kentucky's Uniform Arbitration Act provides that "[a] written agreement to submit any existing controversy to arbitration or a provision in written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law for the revocation of any contract." Ky. Rev. Stat. Ann. § 417.050 (Banks Baldwin 1994).

Plaintiffs contend that prior to December of 1997, the loan agreements did not include an arbitration clause on the reverse side of the loan agreement form. Plaintiffs further contend that Defendants never informed them of the addition of the arbitration clause, and that Plaintiffs only became aware of the clause when Defendants attached it to their motion to compel arbitration.

DISCUSSION

This Court reviews de novo a district court's ruling on whether to compel arbitration pursuant to the FAA. *Stout v. J.D. Byrider, 228* F.3d 709, 714 (6th Cir. 2000). Under the FAA, a district court's consideration of a motion to compel arbitration is limited to determining whether the parties entered into a valid agreement to arbitrate, and does not reach the merits of the parties' claims. *Great W. Mortgage Corp. v. Peacock,* 110 F.3d 222, 228 (3d Cir. 1997).

The district court concluded, primarily under *Three Valleys Municipal Water District v. E.F. Hutton & Co, 925* F.2d 1136, 1139 (9th Cir. 1991), that Plaintiffs' allegations that the loan agreements containing the arbitration clause were void *ab initio,* must be determined by a court, not an arbitrator. Defendants contend that under *Prima Paint Corp. v. Flood & Conklin Mfg. Co.,* 388 U.S. 395 (1967), Plaintiffs' allegations

of void loan agreements are to be determined by an arbitrator.

Under section 3 of the FAA, when an action is brought in federal court "upon any issue referable to arbitration under agreement in writing for such arbitration," the court must "stay the ... action pending arbitration once it is satisfied that the issue is arbitrable under the agreement." *Prima Paint Corp.*, 388 U.S. at 400. "[A]s a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Wilson Elec. Contractors, Inc. v. Minnotte Contracting Corp.*, 878 F.2d 167, 169 (6th Cir. 1989) (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983)).

Under *Prima Paint,* a court, rather than an arbitrator, may adjudicate a claim of fraud in the inducement only if the claim of fraud concerns the inducement of the arbitration clause itself, not the inducement of the contract generally. *Prima Paint,* 388 U.S. at 403-04. 87 S.Ct. 1801. The Court in *Prima Paint* found that arbitration clauses were "separable" from the contracts in which they were included, and that "a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced from fraud." *Prima Paint, 388 U.S.* at 402, 87 S.Ct 1801. "If the arbitration clause is not at issue, then the arbitrator will decide challenges to the contract containing the arbitration clause." *C.B.S. Employees Fed. Credit Union v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 912 F.2d 1563, 1567 (6th Cir. 1990).

Several of our sister circuits have found that *Prima Paint* does not apply to allegations of nonexistent contracts. *See Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 590-91 (7th Cir. 2001); *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99,107 (3d Cir. 2000); *Three Valleys,* 925 F.2d at 1140;

Chastain v. Robinson-Humphrey Co., Inc., 957 F.2d 851, 855 (11th Cir. 1992); *I.S. Joseph Co. v. Mich. Sugar Co.*, 803 F.2d 396, 400 (8th Cir. 1986). The Third Circuit and the Ninth Circuit, respectively, have expressly found that *Prima Paint* applies to voidable, but not void, contracts. *See Sandvik*, 220 F.3d at 107; *Three Valleys*, 925 F.2d at 1140. In contrast, the Fifth Circuit has found that *Prima Paint* applies even to contracts that are "void from ... inception." *See Lawrence v. Comprehensive Bus. Servs. Co.*, 833 F.2d 1159, 1162 (5th Cir. 1987).

The void/voidable distinction is relevant for *Prima Paint* analysis because a void contract, unlike a voidable contract, was never a contract at all. (1) Thus, a valid arbitration agreement "cannot arise out of a broader contract if no broader contract ever existed." *Sandvik*, 220 F.3d at 108. Accordingly, *Prima Paint* "presumes an underlying, existent, agreement." *Id.* at 106.

Although the reasoning of the Third, Seventh, Eighth, Ninth, and Eleventh Circuits is clear, this reasoning appears to be in tension with language in *C.B.S. Employees*, wherein this Court discounted the role of the fraud in the factum/fraud in the inducement distinction under *Prima Paint*. The Restatement provides that § 163, which addresses void contracts, concerns misrepresentations in "the 'factum' or the 'execution' rather than merely the 'inducement'" of the contract. Restatement (Second) of Contracts § 163 cmt. a (1979). Fraud in the factum or execution, "that is, the sort of fraud that procures a party's signature to an instrument without knowledge of its true nature or contents," renders a contract void, while fraud in the inducement renders a contract merely voidable. *W. T. Langley v. FDIC*, 484 U.S. 86, 93-94 (1987) (citations omitted).

However, in C.B.S. Employees we observed that while the "fraud in the factum/fraud in the inducement distinction may offer a legitimate means of analy[sis]," the distinction "may more confound than clarify the dispositive issue and its resolution." *C.B.S. Employees,* 912 F.2d at 1566. Relying on *Prima Paint*, this Court then characterized the "central issue" as "whether CBS' claim of fraud relates to the making of the arbitration agreement. If it does, the court should adjudicate the fraud claim. If it does not, then the [FAA] requires that the fraud claim be decided by an arbitrator." *Id.*

We note that this Court in *C.B.S. Employees,* in not wanting to confound the dispositive question, may in fact have begged the dispositive question. That is, it is not clear that citation *to Prima Paint,* without more, answers the void *ab initio* question, inasmuch as *Prima Paint* failed to address the void ab initio question. Indeed, if anything, we are inclined to find that *Prima Paint* supports, rather than prohibits, excluding nonexistent contracts from the severability doctrine, because an allegation of a void contract raises exactly the same question as an allegation of a fraudulently induced arbitration agreement: whether the arbitrator has any power at all. *Cf. Prima Paint,* 388 U.S. at 404 n.12 ("To immunize an arbitration agreement from judicial challenge on the ground of fraud in the inducement would be to elevate it over other forms of contract"). The Seventh Circuit recently captured the point in four words: "No contract, no power." *Sphere Drake Ins.,* 256 F.3d at 591. Nevertheless, we need not reach the question here, because the district court's application of *Three Valleys* in this case was erroneous and requires reconsideration.

The district court, relying on *Three Valleys,* found that because Plaintiffs had alleged that the loan agreements were void *ab initio*, those allegations were to be determined by the

court, rather than an arbitrator. First, the above is a correct statement of Ninth Circuit law, but the district court failed to address how *Three Valleys* can be reconciled with *C.B.S. Employees*. Second, the district court erred when construing Plaintiffs' allegations under § 288.991 and § 288.420 -- that any loan contract made in violation of § 288.991 shall be void, and that Defendants were not licensed to enter into the loan agreements -- as allegations of void *ab initio* contracts under the *Three Valleys* line of cases.

Consistent with the nature of fraud in the factum allegations, courts have addressed questions of void *ab initio* contracts as questions of signatory power, not contract content. *See Aircraft Braking Sys. Corp. v. Local 856, Int'l Union*, 97 F.3d 155, 157-58 (6th Cir. 1996) (examining whether interim contract existed despite failure to ratify); *Sphere Drake Ins.*, 256 F.3d at 590-91 (determining whether signatory had power to bind company); *Sandvik*, 220 F.3d at 110 (determining whether signatory had power to bind company); *Chastain*, 957 F.2d at 854 (determining whether signatory had power to bind family member); *Three Valleys*, 925 F.2d at 1140 (examining whether signatory had power to bind principals); *I.S. Joseph Co.*, 803 F.2d at 400 (determining whether assignee of signatory had power to enforce arbitration agreement); *Cancanon v. Smith Barney, Harris, Upham & Co.*, 805 F.2d 998, 1000 (11th Cir. 1986) (finding that an allegation of fraud in the factum is an allegation of ineffective assent to the contract); *Par-Knit Mills, Inc. v. Stockbridge Fabrics* Co., 636 F.2d 51, 55 (3d Cir. 1980) (determining whether signatory had power to bind company); *N&D Fashions, Inc. v. DHJ Indus., Inc.*, 548 F.2d 722, 729 (8th Cir. 1976) (examining whether signatory had power to enter into arbitration agreement).

Indeed, the *Three Valleys* decision, on which the district

court primarily relied, offered the following explanation for limiting *Prima Paint* to challenges seeking to "avoid or rescind" an existing contract:

> A contrary rule would lead to untenable results. Party A could forge party B's name to a contract and compel party B to arbitrate the question of the genuineness of its signature. Similarly, any citizen of Los Angeles could sign a contract on behalf of the city and Los Angeles would be required to submit to an arbitrator the question whether it was bound to the contract, even if its charter prevented it from engaging in any arbitration.

Three Valleys, 925 F.2d at 1140. Thus, the illustrations chosen *by Three Valleys* cast doubt on the position that challenges to the very existence of a contract, for purposes of distinguishing *Prima Paint*, include challenges from parties who intended to enter into a contract, but then subsequently discovered that certain terms of the contract may violate state law. That is, the *Three Valleys* line of cases requires more than an allegation of a statutory violation; the substance of the allegation must concern some "misrepresentation as to the character or essential terms of a proposed contract." Restatement (Second) of Contracts § 163 cmt. a (1979).

Plaintiffs' allegations primarily concern the substance of the loan agreements, which Plaintiffs then argue are "void" under § 288.991. However, unlike the *Three Valleys* line of cases, Plaintiffs allegations under § 288.991 do not concern their failure to assent to the loan agreements, and do not concern signatory power. Accordingly, because Plaintiffs' allegations under § 288.991 challenge the substance, rather than the existence, of the loan agreements, we vacate the district court's application of *Three Valleys* to those allegations.

Further, although Plaintiffs' allegations under § 288.420 do concern signatory power, in that Defendants were allegedly not licensed to enter into the loan agreements and thus, Plaintiffs contend, had no authority to enter into the loan agreements, we must nevertheless vacate the district court's application of *Three Valleys* to the allegations under § 288.420 as well. First, Plaintiffs have not addressed why *Three Valleys*, rather than *C.B.S. Employees*, should control the determination of their allegations. Second, Plaintiffs have not addressed the distinction between entering into a loan agreement with an unlicensed lender and not assenting to a loan agreement at all. Although § 2.88.420, like the *Three Valleys* line of cases, raises a question of signatory power, the question in this case is different in that the signatory issue arises only on the side of the parties moving for arbitration. Whether *Three Valleys* requires that parties resisting arbitration allege that they never agreed to any contract at all, is of no moment here because Plaintiff's have not addressed the issue.

Nevertheless, under *Prima Paint,* issues relating to the making of an arbitration agreement, separate from the underlying contract, are to be determined by the court, not the arbitrator. *Prima Paint*, 388 U.S. at 404. "So, for example, a challenge based on fraud in the inducement of the whole contract (including the arbitration clause) is for the arbitrator, while a challenge based on the lack of mutuality of the arbitration clause would be for the court." *Matterhorn, Inc. v. NCR Corp.*, 763 F.2d 866, 868 (7th Cir. 1985) (citations omitted). "If the fraud relates to the arbitration clause itself, the court should adjudicate the fraud claim." *Ferro Corp. v. Garrison Indus.*, 142 F.3d 926, 933 (6th Cir. 1998) (quoting *R.M. Perez &* Assocs., *Inc. v. Welch,* 960 F.2d 534, 539 (5th Cir.1992)). Because the district court relied on *Three Valleys* in denying Defendants' motion to compel arbitration, Plaintiffs'

allegations concerning the making of the arbitration agreements, separate from the loan agreements, were not considered.

Although *C.B.S. Employees* declined to adopt the fraud in the factum/fraud in the inducement distinction when applying *Prima Paint,* nevertheless this Court remanded to the district court in that case allegations of fraud in the inducement of the arbitration agreement itself. *C.B.S. Employees* characterized the *Prima Paint* question as "whether CBS' fraud claim involves the making of the arbitration clause." *C.B.S. Employees*, 912 F.2d at 1568. Specifically, where "the plaintiff affirmatively pleads that the contract and the arbitration agreement included therein were procured through fraud, the court should determine whether the arbitration clause was used to further the fraudulent scheme." *Id.*

Plaintiffs in this case allege, under *C.B.S. Employees,* that the arbitration agreements were used to further a fraudulent scheme. However, Plaintiffs fail to identify, in connection with the alleged fraudulent scheme, any misrepresentation particular to the arbitration agreements, separate from the loan agreements. Allegations that the arbitration agreements furthered the fraudulent scheme are nevertheless arbitrable under Prima Paint. In *Arnold v. The Arnold Corp.*, 920 F.2d 1269, 1280-81 (6th Cir. 1990), this Court noted that under *Prima Paint,* pleading that an arbitration clause "was part of a broader fraudulent scheme. . . without more, is no longer sufficient to overcome the strong federal policy in favor of arbitration."

Specifically, for a complaint of fraud in the inducement to survive *Prima Paint*, the complaint must contain "a well-founded claim of fraud in the inducement of the arbitration

clause itself, *standing apart from the whole agreement*, that would provide grounds for the revocation of the agreement to arbitrate." *Arnold*, 920 F.2d at 1278 (emphasis in original). The only aspect of Plaintiffs' fraud allegations which concerns the arbitration agreements, standing apart from the loan agreements, is the claim that Plaintiffs were not aware that the arbitration clauses had been added to the reverse side of the loan agreements in December of 1997.(2) However, one who signs a contract is presumed to know its contents. *Stout*, 228 F.3d at 715.

Plaintiffs' "fraudulent scheme" claim is unavailing because no aspect of the claim concerns the arbitration agreements, separate from the loan agreements. That is, under *Prima Paint* and *Arnold*, Plaintiffs' fraudulent scheme claim does not constitute a claim of fraudulent inducement concerning the making of the arbitration agreements.(3) Moreover, as noted by Defendants, Plaintiffs did not raise below the claim that the arbitration agreements were used in furtherance of a fraudulent scheme. Thus, in addition to the claim's failure to survive *Prima Paint*, it is also waived. *See Foster v. Barilow*, 6 F.3d 405, 408 (6th Cir. 1993).

Aside from fraud, Plaintiffs raise several alternative grounds on which the arbitration agreements should be found unenforceable. Plaintiffs highlight their particular position as unsophisticated consumers of limited education and means as a key factor in determining the enforceability of the arbitration agreements. These alternative grounds, specifically that arbitration in this case would impose burdensome costs, deny statutory rights, and constitute an uninformed waiver of jury trial rights, attack the enforceability of the arbitration clause itself, separate from the underlying loan agreements.

Under the FAA, generally available contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements. *Doctor's* Assocs., *Inc. v. Casarotto,* 517 U.S. 681, 687 (1996). We note, however, that Plaintiffs' claims as to the unenforceability of the arbitration agreements, separate from the loan agreements, goes against strong precedent. As to the potentially burdensome costs of arbitration, the party resisting arbitration has the burden of showing the likelihood that "arbitration would be prohibitively expensive." *Green Tree Fin. Corp. v. Randolph,* 531 U.S. 79, 81 (2000). As to Plaintiffs' waiver of statutory class action rights, it is Plaintiffs' burden to show that Congress intended such rights to be nonwaivable, a burden that the Eleventh Circuit recently found had not been met under TILA. *Randolph v. Green Tree Fin. Corp.,* 244 F.3d 814, 818 (11th Cir. 2001). As to the failure of the arbitration clause to include a jury waiver provision, "the loss of the right to a jury trial is a necessary and fairly obvious consequence of an agreement to arbitrate." *Sydnor v. Conseco Fin. Servs. Corp.,* 252 F.3d 302, 307 (4th Cir. 2001).(4)

We set out this precedent as an indication of the limited prospects such claims ultimately face. Nevertheless, because these claims attack the enforceability of the arbitration clause separate from the underlying loan agreements, the claims are to be determined by a court, not an arbitrator. When determining the enforceability of an arbitration agreement, a court "can investigate the existence of such grounds as exist at law or in equity for the revocation of any contract ... However, the grounds for revocation must relate specifically to the arbitration clause and not just to the contract as a whole." *Hooters of Am. v. Phillips,* 173 F.3d 933, 938 (4th Cir. 1999) (citing 9 U.S.C. § 2; *Prima Paint,* 388 U.S. at 402-04) (internal quotation marks omitted).

We note that the district court's order in this case, denying Defendants' motion to compel arbitration, was based only on the preliminary determination that Plaintiffs had alleged void *ab initio* contracts, without a subsequent determination that the contracts were actually void *ab initio*. Allegations concerning the validity of an arbitration agreement "should ordinarily be decided in the trial court before final resolution of a motion to compel arbitration." *Chastain*, 957 F.2d at 856 (citations omitted; emphasis omitted). Accordingly, because the district court merely identified, and did not decide, Plaintiffs' allegations concerning the existence and enforceability of the arbitration agreements, we do not construe its order in this case to be a final resolution of Defendants' motion to compel arbitration.(5) Further, we only remand Plaintiffs' allegations that the arbitration agreements, separate from the loan agreements, are not enforceable against them, on "'grounds as exist at law or in equity for the revocation of any contract.'" *Doctor's Assocs.*, 517 U.S. at 683 (quoting 9 U.S.C. § 2).

CONCLUSION

For the above reasons, we **VACATE** the district court's order and **REMAND** for further consideration of Defendants' motion to compel arbitration in light of Plaintiffs' allegations that the arbitration agreements are unenforceable on grounds that the agreements would impose burdensome costs, deny statutory rights, and constitute an uninformed waiver of jury trial rights.

Endnotes

* The Honorable Thomas A. Wiseman, Jr., United States District Judge for the Middle District of Tennessee,

sitting by designation.

[1] Section 163 of the Restatement provides that a "[i]f, because of a misrepresentation as to the character or essential terms of a proposed contract, a party does not know or have reasonable opportunity to know of its character or essential terms, then he neither knows nor has reason to know that the other party may infer from his conduct that he assents to that contract. In such a case there is no effective manifestation of assent and no contract at all." Restatement (Second) of Contracts § 163 cmt. a (1979).

[2] We note that the particular circumstances surrounding Defendants' presentation of the arbitration agreements in this case appear suspect, not because the arbitration clauses were placed on the back of the loan agreements without announcement, but rather because prior to such placement, Plaintiffs had regularly entered into otherwise identical loan agreements that had no arbitration clause. Nevertheless, Plaintiffs offer no legal authority for the position that Defendants had a duty to inform them of their insertion of the arbitration clauses.

[3] Similarly, an additional claim of Plaintiffs, that the arbitration agreements are unenforceable because they were contained in contracts of adhesion, also does not concern the making of the arbitration agreements because the claim does not attack the arbitration clause, separate from the underlying loan agreements.

[4]Notably, however, the arbitration agreement in *Sydnor*, unlike the arbitration agreements in this case, contained an express waiver of jury trial provision . *Sydnor v. Conseco Fin. Servs. Corp.*, 252 F.3d 302, 306 (4th Cir. 2001).

[5] It is not uncommon to obtain appellate review of a district court order denying a motion to compel arbitration brought pursuant to the FAA, prior to the district court's actual determination *of* the allegations giving rise to the order. *See C.B.S. Employees Fed. Credit Union v. Donaldson, Lufkin & Jenrette Sec.* Corp., 912 F.2d 1563, 1566 (6th Cir. 1990) ("The district court concluded that the allegation of fraud in this case is one of 'fraud in the factum' and [thus] the case is one for the court and not the arbitrator to decide."); *Sandvik AB v. Advent Int'l* Corp., 220 F.3d 99, 102 (3d Cir. 2000) ("[T]he District Court concluded that it could not order arbitration until it determined the validity of the underlying contract."); *Chastain v. Robinson -Humphrey Co., Inc.*, 957 F.2d 851, 852 (11th Cir. 1992) (finding that the district court's denial of a motion to compel arbitration "implicitly" ruled that the FAA proscribed compelling arbitration until the district court determined that the party resisting arbitration was "contractually obligated to submit to arbitration").

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
LEXINGTON

BEVERLY BURDEN, CHAPTER 13 TRUSTEE FOR THE ESTATES OF LUTHER GILBERT, JR., VICTORIA TEVIS, SANTINA TURNER, and FRANK LEWIS BRADSHAW AND FRANCINE JACKMAN, ELAINE STEWARD GREENE, LUTHER GILBERT, JR., VICTORIA TEVIS, SANTINA TURNER, and FRANK LEWIS BRADSHAW, INDIVIDUALLY, PLAINTIFFS,	CIVIL ACTION NO. 98-170
V.	**OPINION & ORDER**
CHECK INTO CASH OF KENTUCKY, INC, W. ALLAN JONES, JR,, and UNKNOWN ENTITIES AND INDIVIDUALS, DEFENDANTS.	

******

Presently before the Court is defendants' motion to compel arbitration and stay litigation pending arbitration [DE # 57]. Having been fully briefed, this matter is ripe for review.

Pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, defendants move to compel Sidney White,[1] the Chapter 13 Trustee for the Estates of Luther Gilbert, Jr. and Victoria Tevis, and Francine Jackman, Victoria Tevis, and Luther Gilbert, Jr., individually, to submit their claims to arbitration and to stay this litigation as to those plaintiffs. According to defendants, these plaintiffs signed a written agreement as a part of their transactions with Check Into Cash. This written agreement contained an arbitration clause requiring that all disputes arising under the agreement be submitted to arbitration.

The United States Supreme Court has emphasized the federal policy favoring arbitration and has interpreted the Federal Arbitration Act as establishing that, "'as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.'" *Wilson Elec. Contractors, Inc. v Minnotte Contracting Corp.*, 878 F.2d 167, 169 (6th Cir. 1989) *(quoting Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983)). Regardless of this strong policy favoring arbitration, the Court finds that arbitration is inappropriate in this matter.

In Three Valleys Municipal Water District v. E.F. Hutton & Co., 925 F.2d 1136 (9th Cir. 1991), the Ninth

---

[1] By order entered July 22, 1999 [DE # 38], this Court dismissed Sidney White and substituted Beverly Burden as the Chapter 13 Trustee in this action.

Circuit held that "a party who contests the making of a contract containing an arbitration provision cannot be compelled to arbitrate the threshold issue of the existence of an agreement to arbitrate. Only a court can make that decision." *Id.* at 1140-41. The issue turns on whether the contract is challenged as void ab initio or merely voidable. The *Three Valleys* court stated, "If the dispute is within the scope of an arbitration agreement, an arbitrator may properly decide whether a contract is 'voidable' because the parties have agreed to arbitrate the dispute." *Id* at 1140. However, "because an 'arbitrator's jurisdiction is rooted in the agreement of the *parties,'" id. (quoting George Day Constr. Co. v. United Bhd. of Carpenters, Local 354,* 722 F.2d 1471, 1474 (9th Cir. 1984)), whether a contract ever existed is a question for the court. See *also Aircraft Braking Sys. Corp. v. Local 856, Int'l Union, United Auto., Aerospace and Agricultural Implement Workers,* UAW, 97 F.3d 155, 160 (6th Cir. 1996) (citing *Three Valleys* and stating that "[t]he 'arbitrability' dispute at issue here is not a dispute concerning the scope of an arbitration clause in an otherwise valid agreement, but rather is a dispute as to whether a valid agreement to arbitrate exists at all. This question traditionally has been answered by the courts"); *Chastain v. Robinson-Humphrey Co.,* 957 F.2d 851, 854 (11th Cir. 1992) (stating that where a party challenges the very existence of any agreement, including the existence of an agreement to arbitrate, "there is no presumptively valid general contract which would trigger the district court's duty to compel arbitration"); I.S, *Joseph Co. v. Michigan Sugar Co.,*803 F.2d 396, 399 (8th Cir. 1986) ("[A]ny power that the arbitrator has to resolve the dispute must find its source in a real agreement between the parties. He has no independent source of jurisdiction apart from the consent of the parties. If there is in fact a dispute as to whether an agreement to arbitrate exists,

then that issue must first be determined by the court as prerequisite to the arbitrator's taking jurisdiction.")

Plaintiffs contend that the Check Into Cash agreement containing the arbitration clause is *void ab initio.* Plaintiffs allege that Check Into Cash violated Kentucky's Consumer Loans Act, KRS Ch. 288. KRS 288.991 provides that any loan contract made in violation of the Act is void. In addition, plaintiffs allege that defendants made loans in an amount of $15,000 or less without a license as required by KRS 288.420. "[W]hen a statute requiring a license as a requisite for one practicing a particular profession or for the carrying on of a particular trade or business has been enacted for the protection of the public, an agreement without such a license is void." *Board of Educ. Of Fergurson Indep. Graded Sch. Dist. V. Elliott*, 125 S.W.2d 733, 735 (Ky. 1939). Since plaintiffs challenge the very existence of the agreement containing the arbitration clause, the Court will not compel arbitration of their claims.

Accordingly, the Court, being otherwise fully and sufficiently advised, HEREBY ORDERS that defendants' motion to compel arbitration and stay litigation pending arbitration.

[DE #57] is DENIED.

This ____ day of May, 2000

FORESTER, JUDGE

RENDERED: June_17, 1999

Supreme Court of Kentucky

98-SC-739-CL

SIDNEY N. WHITE, Chapter_13 Trustee
for the Estate of VICTORIA TEVIS,
Estate of SANTINA TURNER,
Estate of REGINA WILLIS, and
Estate of FRANCINE JACKMAN;
VICTORIA TEVIS, Individually;
SANTINA TURNER, Individually; and
REGINA WILLIS, Individually

APPELLANTS

v.

CHECK HOLDERS, INC.; and
UNKNOWN ENTITIES AND INDIVIDUALS

APPELLEES

ON CERTIFICATION FROM
UNITED STATES DISTRICT COURT
V.EASTERN DISTRICT OF KENTUCKY
LEXINGTON DIVISION
98-CV-184

CERTIFICATION OF THE LAW
BY CHIEF JUSTICE LAMBERT

Pursuant to CR 76.37(1), this Court granted the

certification request of the United States District Court for the Eastern District of Kentucky to answer the following question of law.

> When a check cashing company licensed under KRS 368 *et seq.* accepts and defers deposit on a check pursuant to an agreement with the maker of the check, is the service fee charged by the check cashing company a "service fee" and not "interest" under KRS 368.100(2), or is the fee "interest" which is subject to the usury laws and disclosure provisions in KRS Chapter 360?

To resolve this issue of first impression, we must determine whether the General Assembly intended KRS 368.100(2) to encompass short-term loans based upon deferred deposit transactions as well as check cashing from current funds.

In 1992 the General Assembly enacted KRS Chapter 368. The 1992 Act required check cashing businesses to be licensed by the Department of Financial Institutions (DFI), KRS 368.020-.050, and allowed them to charge a fee for cashing checks without implicating Kentucky's usury laws. As stated in KRS 368.100(2):

> Any fee charged by a licensee for cashing a check shall be disclosed in writing to the bearer of the check prior to cashing the check, and the fee shall be deemed a service fee and

not interest.

While the Act clearly applies to check cashing businesses charging fees that might be otherwise considered discounted interest, *see Hamilton v. York*, 987 F.Supp. 953, 956 (1997), it is claimed to apply also to fees charged on short-term loans made by the check cashing licensee. Notably absent from this statutory text, however, is any language directly permitting check cashing businesses to advance funds and charge fees for holding checks, thus providing consumers with short-term loans. Rather, the 1992 Act simply permits check cashing by licensees for a fee providing the fee is disclosed to the drawer.

While the terms of KRS 368.100(2) are not ambiguous, the nature of the transactions at issue here may lead to uncertainty in the statute's application. The source of the uncertainty is the use of an order instrument which is "payable on demand and drawn on a bank" (KRS 355.3-104(6)(a)) to evidence a promise of an indebtedness due at some later time. *See* KRS 355.3-104(5). Thus, in an abundance of caution, we will resort to rules of statutory construction to supplement our analysis.

This Court's duty in construing statutes is to ascertain and give effect to the intent of the General Assembly. *Beckham v. Board of Education*, Ky. 873 S.W.2d 575, 577 (1994). When the words of a statute "are clear and unambiguous and express the legislative intent, there is no room for construction or interpretation and the statute must be given its effect as written." *McCracken County Fiscal Court v. Graves*. Ky. 885 S.W.2d 307, 309 (1994). However, where statutory language is unclear or the intent of the General Assembly cannot be discerned from the face of the

statute, we look for guidance to outside sources, such as legislative history. *Newberg v. Wright*, Ky., 824 S.W.2d 843, 845 (1992). Thus, to determine whether the General Assembly intended to bring deferred deposit service transactions and loans under the purview of the 1992 Act, we turn to legislative history, administrative construction, relevant case law, and the 1998 statutory amendments enacted by the General Assembly in response to *Hamilton v. York*, 987 F. Supp. 953 (1997).

Legislative history reveals that the purpose of the 1992 Act, as explained by one of its sponsors, was to prevent check cashing companies from charging unreasonably high fees to cash payroll checks for unbanked military personnel and to prevent money laundering. Statement of Senator Smith, Third Reading and Vote on HB 747 before the Full Senate, Videotape 50-VVD2 (March 27, 1992), Kentucky Department for Libraries and Archives, Archives Video Vault; 1992 *Leg. Record* House Bill 747 (May 4, 1992), p._157; *see also Hamilton v. York*, 987 F.Supp. 953.956 (E.D. Ky.1997) (noting that, under the 1992 Act, check cashing businesses were authorized to charge fees to cash checks for unbanked people). House Bill 747 was passed without amendment, unanimously in both the House and Senate. 1992 *Leg. Record* House Bill 747 (May 4, 1992), p. 157. Similarly, its companion bill, Senate Bill 311, passed without amendment in the Senate and the House. 1992 *Leg. Record* Senate Bill 311 (May 4, 1992), p. 47-48. The absence of amendments indicates that the sponsors' assessment of the purpose of the 1992 Act was accurate. Thus, we conclude that the intent supporting the 1992 Act was to regulate check cashing services and to prevent money laundering.

The Department of Financial Institutions' (DFI's)

interpretation of the 1992 Act is unclear. On the one hand, DFI is authorized to license deferred deposit service businesses under the 1992 Act. KRS 368.050-080. On the other, DFI failed to promulgate any regulations for the enforcement of Chapter 368 as authorized by KRS 368.090. Significantly, DFI did not interpret the statutory terms "interest" and "fees" in a cohesive regulatory scheme. It also failed to set maximum check-cashing fees. It did not specify how many times a consumer's short-term loan payment on a check deferred for presentment could be delayed or "rolled over", nor did it set maximum fees for "roll over" transactions. Finally, DFI did not determine whether deferred deposit businesses could prosecute drawers for issuing worthless checks after having agreed to advance money and defer deposit of checks the payees knew were worthless. *Cf.* KRS 514.040(1)(e) (which states that a person is guilty of theft by deception when he intentionally issues or passes a check or similar order for the payment of money, knowing that it will not be honored by the drawee).

Regardless of the lack of administrative regulation by DFI, in applying the statute from 1992 to 1998, DFI implicitly construed the Act to include deferred deposit businesses because DFI licenses them to operate. It is a general rule that a "construction of a law or regulation by officers of an agency continued without interruption for a long period of time is entitled to controlling weight." *Hagan v. Farris*, Ky., 807 S.W.2d 488, 490 (1991) (citing *Barnes v. Department of Revenue*, Ky., 575 S.W.2d 169 (1978)). However, this Court limits the deference shown to informal agency interpretations that have been arrived at without rulemaking or an adversarial proceeding. *See Delta Air Lines v. Commonwealth*, Ky. 689 S.W. 2d 14.20 (1985) (holding that "an administrative construction arrived at in an

uncontested nonadversarial proceeding is not entitled to great weight"). *Hagan v. Farris*, Ky., 807 S.W.2d 488, 490 (1991) (*citing Barnes v. Department of Revenue*, Ky., 575 S.W.2d 169 (1978)). However, this Court limits the deference shown to informal agency interpretations that have been arrived at without rulemaking or an adversarial proceeding. See *Delta Air Lines v. Commonwealth*, Ky., 689 S.W.2d 14, 20 (1985) (holding that "an administrative construction arrived at in an uncontested nonadversarial proceeding is not entitled to great weight"). As noted, DFI did not promulgate regulations. Nor did it formally construe the 1992 Act by any adjudicative procedure. Therefore, we do not give DFI's informal interpretation of the 1992 Act any significant weight.

To conclude our analysis of the 1992 Act, we look to *Hamilton v. York*, 987 F. Supp. 953 (E.D. Kentucky 1997), and the statutory changes that followed. In *Hamilton*, consumers asserted that a deferred deposit business, by charging usurious interest for short-term loans on checks deferred for presentment, violated several state and federal statutes, including Kentucky's laws against charging usurious interest. *Id.* at 955-58. The deferred deposit company argued that the 1992 Act permitted the short-term loans and exempted fees charged for the loans from Kentucky's usury statutes. *Id.* at 956. After reviewing the evidence, including the affidavit of DFI's general counsel – which espoused the same agency interpretation discussed above, the court found that the 1992 Act authorized only the operation of check cashing companies. In its holding, the court noted the distinction between interest and service fees.

> KRS 368.100(2) was written so there would be no confusion that if a person walked into a check cashing

> establishment with a government check for $1,000 and the business gave him $900 for the check that the business would not be subject to usury statues because the $100 payment would be a service fee, not discounted interest. The . . . $100 charge is considered a service fee because the business is not receiving the $100 for the use of its money, but rather the service of processing and providing instant cash to unbanked people.

Id.; see also *Miller v. HLT* Check Exchange, 215 B.R. 970, 974 (Bkrtcy. E.D. Ky. 1997) (holding that disbursing funds on the promise of repayment of the sum plus the 'service charge' at a later time is an extension of credit, not check cashing). Furthermore, in *Hamilton* the court hypothesized that if the company's interpretation of the statute was correct, deferred deposit businesses "would not have to stop with short-term loans [since] they could make long-term loans as long as [the loan was made] under the guise of cashing a check." 987 F. Supp. at 956.

The court challenged the Kentucky General Assembly to amend KRS Chapter 368 if the legislature wanted to include deferred deposit businesses within the purview of the statute. *Id.* at n.7. Almost immediately, the General Assembly enacted House Bill 266. According to one of the bill's sponsors, its purpose was to regulate deferred deposit check cashing businesses for the first time. *See* Statement of Representative Jack Coleman, Reading and Vote on HB 226 Before the Full House. Videotape – February 11, 1998,

Legislative Research Commission, Public Information Office. House Bill 226 went through several revisions, but its basic import was never altered by amendment.

The 1998 amendments to KRS Chapter 368 demonstrate that the General Assembly intended for the first time, to bring deferred deposit service businesses under the governance of KRS Chapter 368 and the regulatory authority of DFI. For the first time, the General Assembly defined deferred deposit service businesses, KRS 368.020, and included them in the statute:

> Except as provided in KRS 368.030, no person shall engage in the business of cashing checks *or accepting deferred deposit transactions* for a fee or other consideration without having first obtained a license.

1998 Ky. Acts Ch. 601, s.2 (amending KRS 368.020, amendment emphasized). The phrases "cashing checks" and "accepting deferred deposit transactions" are separated in the statute by the disjunctive word "or" indicating that the statute covers two types of businesses, not one. Furthermore, had the phrase "the business of cashing checks" in the 1992 Act applied to deferred deposit businesses, there would have been no need for the General Assembly to have amended the statute to include deferred deposit businesses.

With enactment of the 1998 amendments, the General Assembly added many requirements specific to deferred deposit transactions. House Bill 226

mandated written agreements between deferred deposit service businesses and their customers. KRS 368.100(14). It capped the amount of fees any check cashing business could charge and banned for-fee "roll-over" transactions by deferred deposit service businesses. KRS 368.100(2), KRS 368.100(15). It limited the time a deferred deposit transaction could be outstanding and limited the amount of money customers could borrow. KRS 368.100(13), KRS 368.090(1), KRS 368.100(11). Finally, House Bill 266 prohibited deferred deposit service business from prosecuting customers for worthless checks. KRS 368.100(17)-(18). In summary, the 1998 Act drew a definite distinction between check-cashing services regulated in the 1992 Act and deferred deposit transactions.

From the foregoing, it is clear that the 1992 Act did not embrace deferred deposit transactions. Accordingly, a deferred deposit business is not, by virtue of KRS 368.100(2), exempt from the application of other laws, including usury laws and disclosure provisions contained in KRS Chapter 360.

The law of Kentucky is so certified to the United States District Court for the Eastern District of Kentucky.

Cooper, Graves, Keller, Johnstone, and Wintersheimer, JJ., concur. Stumbo, J., not sitting.